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TAGS: ECON EFIN EINV ETRD AR
SUBJECT: ARGENTINA: HOLDOUT PROBLEM RIPE FOR RESOLUTION, POLITICS PERMITTING

REF: BUENOS AIRES 1042

Classified By: DCM Tom Kelly for reasons 1.4 (B) and (D)

Summary

¶1. (C) There has been much recent speculation in the Argentine press regarding a possible solution to the problem of the private bondholder "holdouts" from the 2005 Argentine debt restructuring. Deputy EconCouns has met with numerous financial sector contacts in the last several weeks to assess the likelihood of a successful outcome to the GOA negotiations with the holdouts over their non-performing assets, which amount to about USD 20 billion face value in principal claims and USD 10 billion in past-due interest. Since the onset of the global financial crisis and the failure to win compensation for their claims via judicial processes, the holdouts appear to be more interested and flexible than ever in realizing whatever value they can from these assets. For its part, the GOA expects to be facing a growing fiscal gap, as expenditures continue to increase at a rate far greater than the growth in revenues. This will likely continue into the foreseeable future, as the 2011 elections approach and the government steps up spending to solidify and expand its political base. At some point, the internal sources the government has been tapping for financing will run dry and it will need the ability to once again borrow on the international markets. In addition, the fresh inflow of cash the agreement is expected to generate for the GOA and the chance to improve the GOA's debt profile through an exchange of Boden 2012 bonds further increase the attractiveness of a potential agreement. Solving the holdout problem is an indispensable step towards reestablishing international market credibility. Analysts differ as to whether the Ministry of Finance has made the necessary preparations to quickly facilitate an agreement and whether or not the Congress needs to get involved by passing

authorizing legislation. However, all agree that it is in the interests of everyone involved to move forward towards a successful resolution. What remains to be seen is whether the Kirchners will be willing to compromise enough to facilitate a deal. End Summary.

GOA Will Get Fresh Cash

¶2. (U) According to press reports, investors representing about USD 8 billion in non-performing assets have committed to a proposal similar in many ways to the 2005 debt restructuring. It involves an exchange of defaulted GOA debt for discount bonds whose principal is cut to one third of original face value. In addition, the holdouts would receive GDP warrants, whose value depends on the amount Argentina's GDP grows annually -- the greater the growth, the greater the return on the warrants. Of greatest importance to the GOA is that it will not have to pay out any cash, according to the reports. In fact, the bondholders would lend the GOA fresh cash of about USD 1-1.5 billion and pay all underwriting fees. All of the claims against the GOA would be rolled into a new "New York law bond" due in 2016 and carrying a coupon of about 12 percent.

Green Light But Not on Details

¶3. (C) According to Banco Galicia Chief Economist Nicolas

Dujovne, the Secretary of Finance Hernan Lorenzino has the green light to go forward in general with the transaction. However, Nestor Kirchner has yet to agree to the details of the deal. Currently, after the market rally of the past few months, Dujovne says that "the deal is doable and there is much room to negotiate the final financial conditions." He added that the deal will be launched sometime within the next two months since the GOA has come to the realization that its continued high spending and the eventual drying up of internal sources of financing makes the expected USD 1-1.5 billion in cash the deal is expected to generate very attractive. Norberto Lopez Isnardi, Director of Public Credit at the Ministry of Economy, said in a meeting that Minister of Economy Boudou wants to move forward but does not yet have the final clearance from Nestor Kirchner to close a deal. He said that the main banks involved -- Barclays, Deutsche Bank, and Citibank -- are also eager to resolve the issue. Isnardi characterized investors, mainly hedge funds and Gramercy in particular, as "desperate" to conclude a deal since it is costly for them to hold defaulted Argentine debt. He noted that current market conditions would provide for a variety of financial alternatives to be developed to facilitate an agreement; "it is only a question of negotiating the final terms." Isnardi then added that his team has not yet received a concrete proposal.

Boden 2012 Exchange as Part of Deal

¶4. (C) As part of the machinations surrounding a deal, Dujovne also expects the GOA to propose an exchange of the existing Boden 2012 bonds in order to "clear up the GOA maturity profile and alleviate GOA financial needs for the next year or two." In exchange for the Boden 2012, investors would receive the same 2016 bond being proposed for the holdouts. The Boden 2012 stock is about USD 7 billion, of which about USD 3 billion is held abroad and USD 4 billion in Argentina -- about USD 2.5 billion by banks and institutional investors and USD 1.5 billion by retail investors. The participation by institutional investors would add liquidity to the market for the new bond. In addition, the bond would be issued under New York law, unlike the Boden 2012s, which, while denominated in dollars, are issued under Argentine law.

Disagreement on GOA's Preparedness

¶5. (C) One hurdle that might delay the process of coming to an agreement, according to Isnardi, is the need to file an "18K" with the Securities and Exchange Commission (SEC) in order to be able to move forward on a deal. He said that it would only take the GOA about two weeks to prepare the form, but would take the SEC at least two months to review and approve it. In another meeting, Deutsche Bank Argentina President Marcelo Blanco mentioned that an attorney from the U.S. law firm representing Argentine interests vis-a-vis the holdouts came to Buenos Aires on September 24 to complete the details prior to the filing of the 18K. While he alluded to the two-month wait for the SEC to approve the documentation, he was optimistic that a deal could be initiated even before the SEC completes its review. Local Standard and Poor's Sovereign and International Public Finance Ratings Director Sebastian Briozzo said in a separate meeting that he is skeptical that the Ministry of Economy has completed the requisite paperwork to move a deal ahead. He said that any agreement would be extremely complex, much more so, he fears, than the leadership in the Ministry understands. He noted that from his interactions with the professional level at the Ministry, he gained the impression that not much work has been done on the preparation due to a lack of guidance from above. He thought it would take months for the paperwork to be ready to move to the SEC. However, other Embassy sources within the Ministry contest that, indicating that the necessary documentation is all but complete, as evidenced by the September 24 trip to Argentina of the attorney representing Argentine interests. They claim that the attorney would not have come, other than to have completed the final preparatory steps.

Not Clear if New Law Needed

¶6. (C) Embassy contacts differed as to whether or not the Argentine Congress will be required to amend the so-called "Ley Cerrojo," the law approved by Congress in February 2005 that prohibits the GOA from reopening, changing, or settling with creditors who did not participate in the 2005 debt restructuring. Conventional wisdom has been that the Ley Cerrojo prohibits the GOA from offering a "better deal" to the holdouts than the one concluded in 2005, but opinions differ on that. Dujovne maintained that from a legal point of view, there was no need for the Congress to pass a new law to authorize an agreement with the holdouts. He argued that the 2010 Budget Bill includes a clause (article 51) that empowers the executive branch to normalize relations with creditors. Further, the prospectus of the 2005 debt exchange provides rights to participants with regard to future offers as well, giving them the right to exchange the bonds they received in 2005 for bonds offered in any future deal. In addition, Dujovne said that the agreement being contemplated at present is structured so as to make it an offer from the holdouts to the GOA rather than from the GOA to the holdouts, which might, indeed, be prohibited by the law. Regardless of the legal requirements, Dujovne said that the government would in any case need legislation authorizing a new agreement for political cover, preferably before the seating of the new Congress in December.

¶7. (C) In contrast, Isnardi argued that legislation is legally required to authorize a new deal, saying that some imprecise language in this year's budget message is incorrectly leading some people to conclude that a change in law would not be necessary. He added that a lawyer representing Barclays Bank, who was arguing that a new law is unnecessary, was talking "out of fear that passing a new law would complicate and delay the matter." He added that the law firm representing Argentina maintains that it will be necessary for the law to be changed. Mario Blanco of Deutsche Bank agreed, saying that even if not legally

required, he would recommend a change in the law in order to avoid future legal problems.

Banks Will Present a United Front

¶8. (C) The three main banks involved in the negotiations -- Citibank, Deutsche Bank, and Barclays -- are currently working independently, according to Blanco, although he indicated that they would probably present a united front to the government if and when the negotiations reach a more advanced stage. He noted that the GOA had not yet officially recognized them as representatives of the holdouts in the negotiations. When that happens, Blanco said that Barclays would primarily be representing the hedge funds and Deutsche the European investors. He was unsure of Citibank's role,

and assumed it would represent other investors who were not in the first two categories.

Comment

¶9. (C) Coupled with what Secretary of Finance Lorenzino indicated at an earlier meeting (see reftel), it is clear that there is a certain amount of behind-the-scenes movement taking place on the holdout issue. Some of this has become known to the press, resulting in breathless headlines and articles about an agreement being imminent. Most agree that it would be in everyone's interest for the GOA to finalize an agreement with the holdouts and then move on to reaching an agreement with the Paris Club creditors. However, what remains unclear is the extent to which the GOA leadership is really committed to do a deal. There is a long history of the GOA raising hopes regarding a resolution of the debt issue, only to dash them later. The confluence of a weakened Presidency, a weak economy, the inevitable need to raise money somehow, and bondholders looking to salvage something from a catastrophic investment ought to quickly lead to a deal. However, it is all up to the Kirchners, and whether they will ultimately approve a deal is anybody's guess.

MARTINEZ